Filed 9/16/03 Kim v. Allstate Ins. Co. CA2/7

**NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS**



IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

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| DONG SU KIM et al.,<br><br>Plaintiffs and Appellants,<br><br>v.<br><br>ALLSTATE INSURANCE COMPANY,<br><br>Defendant and Respondent. | B157344<br><br>(Los Angeles County<br>Super. Ct. No. LCO 30418) |

APPEAL from a judgment of the Superior Court for the County of Los Angeles. Harvey A. Schneider and Joseph R. Kalin, Judges. Reversed and remanded.

King & Kent, King & Miller, David P. King and Katharine A. Miller for Plaintiffs and Appellants.

Luce, Forward, Hamilton & Scripps, Charles A. Bird and Ronald D. Getchey for Defendant and Respondent.

Dong Su Kim and Kyoung Joo S. Oh (the Kims) sued Allstate Insurance Company, their homeowners' insurance carrier, for breach of contract and breach of the duty of good faith and fair dealing based on Allstate's allegedly unsatisfactory response to a claim arising out of the January 17, 1994 Northridge earthquake. After both sides had announced "ready" for trial following more than five years of claims activity and almost three years of contentious litigation, the trial court granted Allstate's belated motion to submit the value of the loss to appraisal, as provided in the Kims' insurance policy.

The appraisal panel set the amount of the Kims' loss; Allstate promptly paid the amount of loss in excess of the Kims' deductible; and the trial court granted the Kims' petition to confirm the appraisal award. Allstate then successfully moved for summary judgment on the theory that, because the insurance policy provided for appraisal and Allstate had timely paid the appraisal award, it was not liable for either breach of contract or breach of the implied covenant of good faith. Allstate was awarded nearly $95,000 in costs of suit.

The Kims appeal from the judgment, contending, in part, that the trial court erred in granting Allstate's motion for an appraisal. Although it pains us to remand this matter for trial as the 10th anniversary of the Northridge earthquake approaches, we agree with the Kims and reverse the judgment.

## FACTS AND PROCEEDINGS BELOW

1. *The Earthquake and Allstate's Adjustment Process*

The Kims own a large home in Woodland Hills, California (the property), which was insured in January 1994 under a homeowners' policy issued by Allstate. With respect to Allstate's obligation to pay its insureds for covered losses, the policy provides, "We will settle within 60 days after the amount of loss is finally determined. This amount may be determined by an agreement between you and us, an appraisal award or a court judgment." "Appraisal," as provided by the policy, is a form of tripartite arbitration to resolve disputes concerning the amount of a loss that may be triggered by a request

from either the homeowner or Allstate: "If you and we fail to agree on the amount of loss, either party may make written demand for an appraisal."

After the Northridge earthquake the Kims immediately submitted a claim under their Allstate homeowners' policy. Allstate initially determined the earthquake had caused only minor cosmetic damage to the property, with repair costs of less than the Kims' $43,970 deductible. Allstate closed the file on the Kims' claim in April 1994.

The Kims asked Allstate to reevaluate their claim and provided Allstate with a repair proposal totaling $253,362. Allstate responded by re-opening the Kims' claim file and preparing a revised estimate of $74,851 to repair all the earthquake damage identified by its experts. On December 16, 1994 Allstate paid the Kims $30,880.94 (its $74,851 repair estimate less the $43,970 deductible). The Kims were not satisfied with the amount and did not deposit the check.

The Kims filed suit against Allstate on January 17, 1995, alleging breach of contract and a tortious breach of the implied covenant of good faith. The initial complaint was never served. In April and May 1995 Allstate continued to adjust the Kims' claim, performed additional inspections of the property and obtained a supplemental engineering report. On May 30, 1995 Allstate informed the Kims it would not be changing its position on the amount of the Kims' loss.

2. *The Litigation*

The Kims filed a first amended complaint on May 2, 1996 and served it on Allstate. Allstate answered the complaint. The trial court initially set the case for trial on October 9, 1997.

The parties then embarked upon contentious discovery proceedings. Both Allstate and the Kims served interrogatories and requests for production of documents. Allstate took the depositions of the Kims in March 1997. There were multiple discovery motions by both sides. Throughout the discovery process Allstate asserted the Kims were attempting to prevent Allstate from learning the basis for the Kims' disagreement with Allstate's valuation of their loss. Neither Allstate nor the Kims sought to invoke the

insurance policy's appraisal provision, which provided the mechanism for an expedited resolution in the event the parties "fail to agree on the amount of the loss."

In July 1997 the trial court stayed all law and motion and discovery and continued the trial date to August 26, 1998 to permit the parties to engage in nonbinding mediation. The mediation took place in February 1998, but failed to result in a settlement. The parties' rancorous discovery proceedings resumed, including expert witness depositions and a hotly contested and ultimately successful motion by Allstate to compel another inspection of the property.

The parties served proposed statements of the case, witness lists, exhibit lists and jury instructions in preparation for the scheduled August 26, 1998 trial. In addition, Allstate submitted 20 motions in limine and a 26-page trial brief. When the case was called for trial, both parties answered "ready," although Allstate informed the court it was still waiting to inspect the property.

Allstate finally inspected the property with its structural engineer on August 28, 1998. After the Kims took the structural engineer's deposition and the parties reviewed his report, the parties entered into settlement discussions. Meanwhile, the case was twice assigned to courtrooms for trial, but the parties exercised peremptory challenges against the assigned judges. The parties then appeared before the presiding judge and acknowledged trial would take place with the next available judge.

The Kims rejected Allstate's offer of binding "high-low" arbitration on January 11, 1999. On the day of a scheduled telephone status conference with the court, during which the case presumably would have been sent out for trial, Allstate faxed the Kims a demand for an appraisal. When the Kims refused to agree to Allstate's demand, Allstate moved to compel appraisal. The trial court granted Allstate's motion on March 18, 1999. The Kims petitioned this court for a writ of mandate, which was summarily denied on April 23, 1999.

The appraisal panel issued an award determining the actual cash value of the Kims' loss to be $103,647.19. Allstate immediately paid the Kims the difference between the appraisal award and the amount it had already paid under the policy.

The Kims petitioned to confirm the appraisal award, specifically reserving their right to appeal the court's order requiring the appraisal. They also sought judgment in their favor on their contract claim plus prejudgment interest on the appraisal award. The trial court confirmed the award but deferred the issues of prejudgment interests and costs until a final judgment in the entire action. The court found that the appraisal had not determined whether there was a breach of contract by Allstate, but only determined the amount of earthquake damage to the property.

The parties both moved for summary adjudication on the Kims' claim for breach of contract. The trial court denied the Kims' motion and granted Allstate's motion on the theory that Allstate's payment of the appraisal award established Allstate owed nothing under the insurance policy and, therefore, the Kims were not entitled to any remedy for breach of contract.

Allstate then moved for summary adjudication on the Kims' claims for breach of the implied covenant of good faith and fair dealing and punitive damages. Again, it argued that, because it had timely paid the appraisal award, it had never failed to pay any monies due and any delay in payment was the result of a bona fide dispute about whether Allstate owed any monies other than those paid in December 1994. The trial court granted Allstate's motion and entered judgment in Allstate's favor. It ultimately awarded Allstate nearly $95,000 as costs of suit.

## CONTENTIONS

The Kims contend the trial court abused its discretion when it ordered a contractual appraisal of the amount of the covered loss because the uncontroverted evidence established, as a matter of law, that Allstate had waived the right to demand an appraisal by waiting almost five years and participating in substantial litigation activity before making its demand. Allstate contends that the Kims have waived their right to

challenge the court's order sending the matter to appraisal by accepting the benefits of the appraisal award and moving the trial court to confirm it and that, in any event, it promptly moved for an appraisal once it learned there was a "bona fide" dispute as to the amount of the Kims' loss.

**DISCUSSION**

"An agreement to conduct an appraisal contained in a policy of insurance constitutes an 'agreement' within the meaning of [Code of Civil Procedure] section 1280, subdivision (a),[1] and therefore is considered to be an arbitration agreement subject to the statutory contractual arbitration law." (*Louise Gardens of Encino Homeowners' Assn., Inc. v. Truck Ins. Exchange, Inc.* (2000) 82 Cal.App.4th 648, 658, fn. omitted (*Louise Gardens*).) Although in general arbitration is a highly favored means of settling disputes, a petition to compel arbitration must be denied if the trial court finds the moving party has waived that right. (§ 1281.2, subd. (a); *Berman v. Health Net* (2000) 80 Cal.App.4th 1359, 1363 (*Berman*).)[2]

The question of wavier is normally one of fact, and an appellate court's function is to review a trial court's findings regarding waiver to determine whether these are supported by substantial evidence. (*Berman, supra,* 80 Cal.App.4th at p. 1363.) If more than one reasonable inference may be drawn from the undisputed facts, the substantial evidence rule requires indulging the inferences favorable to the trial court's judgment. (*Davis v. Continental Airlines, Inc.* (1997) 59 Cal.App.4th 205, 211.) However, a trial court's finding of either waiver or nonwaiver must be reversed if the record, as a matter of law, compels the contrary conclusion. (*Berman,* at p. 1363; *Guess?, Inc. v. Superior*

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1 All statutory references are to the Code of Civil Procedure unless otherwise indicated.

2 Although the term "waiver" is generally defined as the voluntary relinquishment of a known right, the term is also used "as a shorthand statement for the conclusion that a contractual right to arbitration has been lost." (*Platt Pacific, Inc. v. Andelson* (1993) 6 Cal.4th 307, 315.)

*Court* (2000) 79 Cal.App.4th 553, 557 (*Guess?*) ["For us, the question is whether the trial court's decision is supported by substantial evidence. If it is, we must affirm. If not, we may decide the issue as a matter of law."].)

1. *The Kims Have Not Waived Their Right to Challenge the Order Compelling Appraisal on Appeal*

In *Louise Gardens, supra*, 82 Cal.App.4th 648, a homeowners' association sought to avoid the result of an appraisal that established the amount of its loss from the Northridge earthquake on the ground the insurer's designated arbitrator should have disqualified himself or been disqualified by the court. Because the association had not filed a petition to vacate the appraisal on that ground, but had instead filed a petition to confirm the award, Division Three of this court held the disqualification issue could not be raised in an appeal from the judgment entered following the order of confirmation. (*Id.* at p. 659.) Based on *Louise Gardens* Allstate asserts the Kims waived their right to challenge the trial court's order sending the matter to appraisal by petitioning to confirm the award and accepting payment from Allstate. Allstate's argument misapprehends the holding of *Louise Gardens*.

As Division Three explained, the provisions of section 1280 *et seq.* governing contractual arbitration "represent a comprehensive statutory scheme for the arbitration of disputes." (*Louise Gardens, supra,* 82 Cal.App.4th at p. 658.) In *Louise Gardens* the homeowners' association did not file a petition to vacate the award, despite the fact it always contended the insurer's arbitrator should have been disqualified. (*Id.* at p. 659.) Instead, it petitioned to *confirm* the award and then raised its objection on appeal from the resulting judgment. (*Ibid.*) The Court of Appeal held "[a] party who fails to timely file a petition to vacate under section 1286 may not thereafter attack that award by other means *on grounds which would have supported an order to vacate*." (*Ibid*., italics added.)

In contrast to the situation in *Louise Gardens*, the issue raised on appeal in the case at bar is not one of the enumerated grounds for vacating an arbitration award under

section 1286.2.[3] To the contrary, the arbitration statutes provide that the issue raised in the Kims' appeal -- whether the party seeking to compel arbitration had waived the right to do so -- is to be resolved *before* the arbitration takes place, pursuant to section 1281.2.[4] A party who has unsuccessfully litigated the waiver issue in proceedings pursuant to 1281.2 is not required to raise the issue again in a motion to vacate pursuant to section 1286.2. (*United Firefighters of Los Angeles v. City of Los Angeles* (1991) 231 Cal.App.3d 1576, 1582 ["because appellants had nothing new to add to their opposition to the arbitration, requiring them to make a request to vacate the award would be a needless act and a waste of judicial resources"].) Accordingly, the Kims' petition to confirm the award, which expressly stated it was brought without prejudice to their right to appeal the order sending the matter to appraisal, did not waive their right to raise that issue on appeal.

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[3] Section 1286.2 provides, "[T]he court shall vacate the award if the court determines any of the following: [¶] (1) The award was procured by corruption, fraud or other undue means. [¶] (2) There was corruption in any of the arbitrators. [¶] (3) The rights of the party were substantially prejudiced by misconduct of a neutral arbitrator. [¶] (4) The arbitrators exceeded their powers, and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted. [¶] (5) The rights of the party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefor or by the refusal of the arbitrators to hear evidence material to the controversy or by other conduct of the arbitrators contrary to the provisions of this title. [¶] (6) An arbitrator making the award either: (A) failed to disclose within the time required for disclosure a ground for disqualification of which the arbitrator was aware; or (B) was subject to disqualification upon grounds specified in Section 1281.91 but failed upon receipt of timely demand to disqualify himself or herself as required by that provision. . . ."

[4] Section 1281.2 provides, "On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that: [¶] (a) The right to compel arbitration has been waived by the petitioner; or [¶] (b) Grounds exist for revocation of the agreement."

2. *The Trial Court Erred in Granting Allstate's Motion to Compel Appraisal*

Allstate's principal argument against waiver -- and the argument the trial court adopted in granting the motion to compel an appraisal[5] -- is that the proponent of waiver must establish that there has been a judicial determination on the merits of the issue to be appraised. Quoting from *Hall v. Nomura Securities International* (1990) 219 Cal.App.3d 43, 51, Allstate asserted in the trial court, "'Waiver [of the right to demand arbitration] does not occur by mere participation in litigation; there must be "judicial *litigation* of the merits of arbitrable issues" [citation] . . . .'"

Allstate's and the trial court's insistence that there must be a final adjudication on the merits of an issue subject to arbitration before a waiver can be found is simply incorrect. As the Supreme Court has explained, "We have stressed the significance of the presence or absence of prejudice. Waiver does not occur by mere participation in litigation; there must be 'judicial *litigation* of the merits of arbitration issues' [citation], although 'waiver could occur prior to a judgment on the merits if prejudice could be demonstrated' [citation]." (*Keating v. Superior Court* (1982) 31 Cal.3d 584, 605, overruled on other grounds in *Southland Corp. v. Keating* (1984) 465 U.S. 1 [104 S.Ct. 852, 79 L.Ed.2d 1]; accord, *Groom v. Health Net* (2000) 82 Cal.App.4th 1189, 1194.)

Indeed, there is no single test for waiver of the right to compel arbitration. (*Christensen v. Dewor Developments* (1983) 33 Cal.3d 778, 782; *Davis v. Continental Airlines, Inc., supra,* 59 Cal.App.4th at p. 211.) Rather, wavier may be found where the party seeking arbitration has (1) previously taken steps inconsistent with an intent to invoke arbitration, (2) unreasonably delayed in seeking arbitration, or (3) acted in bad faith or with willful misconduct. (*Berman, supra,* 80 Cal.App.4th at p. 1363; *Davis*, at pp. 211-212.)

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[5] In ruling that Allstate had not waived its right to compel appraisal of the Kims' alleged losses, the trial court explained, "My belief is that for a waiver of the contract provision of an appraisal to apply, that there has to have been a litigation of an arbitrable issue, and I don't see that there has been litigation of an arbitrable issue."

In this case, viewing the record before the trial court as a whole, there is no evidence to support the trial court's refusal to find waiver. To the contrary, the record plainly establishes that Allstate repeatedly acted in a manner that was inconsistent with an intent to demand appraisal and unreasonably delayed asserting its right to do so. Furthermore, the Kims demonstrated significant prejudice as a result of Allstate's conduct. Accordingly, the motion to compel an appraisal should have been denied. (*Guess?*, *supra*, 79 Cal.App.4th at p. 559 [issuing peremptory writ of mandate compelling the trial court to vacate its order granting motion to compel arbitration and entering a new order denying the motion].)

a. *Allstate's Conduct Was Inconsistent With an Intent to Seek Appraisal*

There is no question that Allstate's conduct, from the time the Kims first made a claim under their policy, was entirely inconsistent with an intention to invoke the appraisal process. (See *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1980) 105 Cal.App.3d 946, 952, fn. 2 [in ruling on a claim of waiver, "[t]he trial court must . . . view the litigation as a whole and determine if the parties' conduct is inconsistent with a desire to arbitrate."].)

First, Allstate failed to plead the existence of the appraisal provision as an affirmative defense when it answered the Kims' complaint. "[A]n agreement to arbitrate is an affirmative defense" that generally must be pleaded. (*Ross v. Blanchard* (1967) 251 Cal.App.2d 739, 742; *California Academy of Sciences v. County of Fresno* (1987) 192 Cal.App.3d 1436, 1442.) Although a failure to plead arbitration as an affirmative defense, standing alone, may not be sufficient to constitute waiver (*Fischer v. A.G. Becker Paribas Inc.* (9th Cir. 1986) 791 F.2d 691, 698 [relying on Federal Arbitration Act]), "[a]t a minimum, the failure to plead arbitration as an affirmative defense is an act inconsistent with the later assertion of a right to arbitrate." (*Guess?*, *supra*, 79 Cal.App.4th at p. 558.)

Second, it was apparent from the outset that the parties disagreed as to the amount of the loss. Nonetheless, Allstate did not seek an appraisal before it was served with the

Kims' first amended complaint several years after the Northridge earthquake and the presentation of the Kims' initial damage claim. After it answered the complaint, Allstate litigated for almost three more years, engaged in extensive discovery including discovery motions, participated in a failed mediation and even answered "ready" for trial months before it moved to compel an appraisal. In *Guess?, supra,* 79 Cal.App.4th at page 558, the defendant's conduct was found "wholly inconsistent with its present desire to arbitrate" where, inter alia, it "fully participated in the discovery process," it "remained mute on the subject of arbitration" for four months while engaging in discovery disputes and taking "full advantage of the opportunity to test the validity of [plaintiff's] claims, both legally and factually." This description applies equally to Allstate, with the exception that Allstate engaged in such activities for more than three *years*.

Allstate's position that it was not required (or even entitled) to invoke the appraisal provision until it had engaged in sufficient litigation to satisfy itself that the Kims' disagreement as to the amount of loss was "bona fide" is not supported by either the law or the language of the policy itself, which states simply "If you and we fail to agree on the amount of loss, either party may make written demand for an appraisal." Accepting Allstate's invitation to read a "bona fide dispute" requirement into the policy's appraisal provision would completely undercut the usefulness of the appraisal process as a quick and inexpensive alternative to litigation. (See *Victoria v. Superior Court* (1985) 40 Cal.3d 734, 750; *Pierotti v. Torian* (2000) 81 Cal.App.4th 17, 35.) "[T]he purpose of arbitration is to voluntarily resolve private disputes in an expeditious and efficient manner. [Citations.] Parties to arbitration voluntarily trade the formal procedures and the opportunity for greater discovery and appellate review for '"the simplicity, informality, and expedition of arbitration."' [Citations.]" (*Broughton v. Cigna Healthplans* (1999) 21 Cal.4th 1066, 1080.)

Where a party delays seeking arbitration and instead engages in years of litigation up to the very eve of trial, there is no public policy reason to permit arbitration. To the contrary, "'The courtroom may not be used as a convenient vestibule to the arbitration

hall so as to allow a party to create his own unique structure combining litigation and arbitration.' [Citation.]" (*Christensen v. Dewor Developments*, *supra*, 33 Cal.3d at p. 784.) As the court noted in *Sobremonte v. Superior Court* (1998) 61 Cal.App.4th 980, 996, finding a waiver of arbitration by participation in discovery and trial preparation, "Arbitration is an expedient, efficient and cost-effective method to resolve disputes. If we consider the amount of time and money [the parties] have already spent in the judicial system, any benefits they may have achieved from arbitration have been lost." (See also *Davis v. Continental Airlines, Inc*., *supra*, 59 Cal.App.4th at pp. 211-212 [waiver may occur where the party has "unreasonably delayed in seeking arbitration"].)

There was never a time when the Kims and Allstate agreed on the amount of the Kims' loss due to earthquake damage. By its terms, the appraisal procedure could have been invoked by either party at any time. (See *Guess?, supra,* 79 Cal.App.4th at p. 557 [party's knowledge of arbitration provision since before lawsuit was filed was a factor in finding waiver].) If Allstate was truly frustrated in its efforts to resolve its dispute with the Kims by the Kims' refusal to provide meaningful discovery responses, a timely demand for appraisal would have put a swift end to the Kims' evasive tactics by forcing them to present their evidence of loss as part of the appraisal process. Allstate is simply not entitled to litigate until it satisfies itself that the insured's disagreement is "bona fide" before invoking its right to appraisal.

b. *The Kims Were Prejudiced by Allstate's Delay in Seeking An Appraisal*

A party who seeks to establish waiver must show that some prejudice has resulted from the other party's delay in seeking arbitration. (*Keating v. Superior Court, supra,* 31 Cal.3d at p. 605; *Berman, supra,* 80 Cal.App.4th at p. 1364.) Sufficient prejudice to sustain a finding of waiver exists when a party takes advantage of pretrial discovery not available in the arbitration. (*Id.* at pp. 1370-1371.) Further, prejudice caused by obtaining information from plaintiff through discovery is not overcome simply because the plaintiff has also obtained discovery. (*Id.* at p. 1370.) The court may also consider the length of the delay in demanding arbitration and the expense incurred by the other

party from participating in the litigation process. (*Sobremonte v. Superior Court, supra,* 61 Cal.App.4th at p. 995.)

The Kims plainly suffered prejudice from Allstate's conduct. The parties engaged in exhaustive discovery and, as in other cases where prejudice was found to support a waiver of the right to arbitration, "the defendant learned all the details of the plaintiff's case before demanding arbitration." (*Groom v. Health Net, supra,* 82 Cal.App.4th at p. 1196; see also *Berman, supra,* 80 Cal.App.4th at pp. 1367-1368 [plaintiffs were prejudiced when "discovery forced [them] to reveal their hand"]; *Davis v. Continental Airlines, Inc.*, *supra*, 59 Cal.App.4th at p. 215 [prejudice occurs where "defendants used the discovery processes of the court to gain information about the plaintiff's case which defendants could not have gained in arbitration"].)

Allstate's years-long delay in seeking to compel an appraisal also cost both parties the expense of litigating the Kims' claims up to the very eve of trial, a substantial sum that could and should have been avoided had Allstate sought an appraisal in a timely manner. (See *Guess?*, *supra*, 79 Cal.App.4th at p. 558; *Sobremonte v. Superior Court*, *supra*, 61 Cal.App.4th at p. 996; *Davis v. Continental Airlines, Inc*., *supra*, 59 Cal.App.4th at p. 216 ["a defendant should timely seek relief either to compel arbitration or dispose of the lawsuit, before the parties and the court have wasted valuable resources on ordinary litigation."].) This additional prejudice further compels a finding of waiver.[6]

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[6] Because we find the trial court erred in compelling appraisal, the court's subsequent rulings on the parties' cross-motions for summary judgment, which were expressly based on the results of the appraisal, must necessarily be vacated as well.

## DISPOSITION

The judgment is reversed. The case is remanded for further proceedings not inconsistent with this opinion. The Kims are to recover their costs on appeal.

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

PERLUSS, P. J.

We concur:

WOODS, J.

MUNOZ (AURELIO), J.*

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* Judge of the Los Angeles Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.